

Decision **DRAFT DECISION OF ALJ PULSIFER** (Mailed 3/5/2002)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the
Commission's Own Motion Into Competition for
Local Exchange Service.

Rulemaking 95-04-043
(Filed April 26, 1995)

Order Instituting Investigation on the
Commission's Own Motion Into Competition for
Local Exchange Service.

Investigation 95-04-044
(Filed April 26, 1995)

**OPINION GRANTING MOTION OF
ROSEVILLE TELEPHONE COMPANY****Summary**

On May 1, 2001, Roseville Telephone Company (Roseville) filed a motion for an order requiring all competitive local exchange carriers (CLECs) to provide security for the difference between the unbundled network element (UNE) rates adopted by the Commission in Decision (D.) 00-06-080 and the interim UNE prices allegedly based on a proxy and subject to true up in D.01-02-042. Roseville claims that such security is needed to protect itself and its customers from the risk that a CLEC may not be financially able to pay the final UNE prices once the true up occurs. We hereby grant Roseville's motion to the extent set forth below.

Background

As a basis for its motion, Roseville makes reference to D.00-06-080. In this decision, the Commission affirmed the results adopted in the Final Arbitrator's

Report relating to Application 00-01-012, the arbitration of the interconnection agreement between Covad Communications Company (Covad) and Roseville.

In D.00-06-080, the Commission adopted Roseville's proposed prices for UNEs. Covad sought rehearing to challenge the Commission's decision on UNE's. While rehearing was pending, Roseville entered into interconnection agreements with other CLECs which adopted the UNE rates in the Covad arbitration.

In D.01-02-042, the Commission granted rehearing, and set temporary UNE prices based on Pacific's UNE rates which will be subject to true up after further proceedings to determine final UNE prices for Roseville. For the reasons discussed in and found persuasive by the Commission in D.00-06-080, Roseville believes its final UNE prices will probably be higher than Pacific's. Accordingly, Roseville anticipates that CLECs will owe Roseville the difference between the interim UNE rates adopted in D.01-02-042 and the final UNE rates which have yet to be established.

Roseville claims that it has a legitimate interest in ensuring the payment of the amounts it will be owed if the final UNE rates adopted by the Commission are higher than the interim rates adopted in the order granting rehearing. Accordingly, Roseville wants assurance from any party to an interconnection agreement seeking UNEs at the temporary rates adopted in the order granting rehearing that it has the financial ability to pay the amounts ordered as part of a future true-up when Roseville's final UNE rates are established.

Roseville, therefore seeks an order requiring a security deposit in an amount equal to the difference between the interim UNE rates adopted in the order on rehearing and the rates adopted in D.00-06-080 during the period that the Commission is considering Roseville's final UNE rates. As an alternative,

Roseville proposes that the CLECs could be required to post a bond, letter of credit, guarantee, or other security found reasonably acceptable to protect Roseville and its subscribers.

Absent these security provisions, Roseville claims it will be at risk for substantial sums of money that might be lost if CLECs that have obtained UNEs at the interim rates adopted in the order granting rehearing are unable to pay the amount due when these rates are trued-up to Roseville's final UNE rates.

A response in opposition to Roseville's motion was jointly filed by Z-Tel Communications, Inc., WorldCom, Inc., Sprint Communications L.P., and Rhythms Links, Inc. (Joint Parties). The Joint Parties oppose the motion, arguing that the requirements that Roseville seeks to impose should have been negotiated or arbitrated a year ago, prior to the Commission's approval of the Roseville/Covad interconnection agreement. Under Section 252(b)(4)(A) of the Telecommunications Act of 1996 (the "1996 Act") and Rule 3.10 of Resolution ALJ-181, the issues that may be decided by the Commission in arbitrating an interconnection agreement are limited to those raised in the petition for arbitration and the response thereto, both of which were filed long ago.

Accordingly, the Joint Parties argue that any right that Roseville may have to re-open negotiations with CLECs regarding the terms for obtaining UNEs or other provisions depends solely on the language of the parties' approved interconnection agreements, but that Roseville does not have the right to seek unilateral modifications to approved interconnection agreements merely by filing generic motions with the Commission.

Moreover, the Joint Parties argue that it would be impossible to set an appropriate deposit level because there is no way to know what Roseville's

permanent prices will be. The Joint Parties further claim that deposit requirements should never apply to customers, including CLECs, with good payment histories.

Roseville filed a third-round reply on May 29, 2001, taking exception to the arguments of the Joint Parties, and contending that its motion does not violate the rules governing negotiation and arbitration of interconnection agreements. Roseville argues that its proposal is workable and necessary given the questionable financial status of CLECs.

On November 2, 2001, the assigned ALJ issued a ruling calling for additional information from Roseville relating to the specific interconnection agreements, and the level of security that would be required from each CLEC with which it has an interconnection agreement. Roseville filed a response in compliance with the ALJ ruling on November 21, 2001, providing the information set forth in the ruling.

Discussion

We believe that Roseville has raised a valid concern regarding the potential risk that Covad, as well as other CLECs that are not creditworthy, may not be financially able to pay the UNE rates that may ultimately be adopted. If final UNE rates turn out to be higher than the current interim rates, certain CLECs with limited or no surplus cash reserves may find it difficult to pay Roseville for any shortfall relating to past underpayments.

This concern cannot be dismissed merely as something that should have been addressed during the negotiation or arbitration phases of Roseville's interconnection agreements with CLECs. We appreciate that Roseville did not anticipate the specific risk of collecting the difference between the interim and final UNE rates at the time that it negotiated the Covad interconnection

agreement. During the time Roseville negotiated the Covad interconnection agreement, however, it could not reasonably have foreseen that the Commission would grant rehearing of UNE rates in D.01-02-042. In D.01-02-042, the Commission also adopted Pacific's lower UNE prices, as approved in D.99-11-050, as the proxy for Roseville's interim UNE prices, subject to true-up, with interest, upon the approval of final prices. It was this subsequent act of the Commission, therefore, that created the uncertainty as to what level of UNE rates would ultimately be required of the CLECs. Roseville is concerned that Covad, or other CLECs, may not have sufficient funds to pay any increased UNE charges attributable to the true up once final rates are determined. Roseville raises the concern that CLECs are not credit worthy risks, and provides anecdotal evidence of the financial problems facing at least some CLECs. We have no reason to doubt that at least some CLECs with which Roseville has interconnection agreements may be facing financial difficulties. No other party presented any evidence contradicting the indications of financial difficulties facing various CLECs. The preexisting financial problems of various CLECs thus imposed increased risk on Roseville after the issuance of D.01-02-042. This increased risk resulted from the uncertainty created by D.01-02-042 as to what UNE charges would ultimately be due and payable to Roseville, and whether CLECs would have sufficient funds to remit any back payments that may become due once a final UNE rate order was issued. Consequently, Roseville should not be penalized for failing to negotiate a security provision in its interconnection agreements related to a subsequent risk that was created by action of the Commission.

We recognize that the issues that may be decided by the Commission in arbitrating interconnection agreements are limited to those raised in the petition

for arbitration. Yet, granting the relief requested by Roseville does not involve relitigating the arbitration of any interconnection agreement. The Commission has ongoing authority within this rulemaking proceeding to adopt or modify rules governing local competition that are in the public interest.

In this instance, we conclude that it is reasonable to adopt measures to mitigate the risk of CLEC nonpayment at issue here since that risk was created by an action of the Commission that was not reasonably foreseeable at the time Roseville negotiated or arbitrated interconnection agreements that predated D.01-02-042. Thus, in view of the financial difficulties facing CLECs generally, together with the additional risk of nonpayment of UNE charges created by the rehearing granted in D.01-02-042, we conclude Roseville's motion seeking financial security from CLECs should be granted.

We recognize that there is uncertainty as to the UNE prices the Commission will finally adopt. Nonetheless, we believe the risk of nonpayment is reasonably approximated by relating the level of security to the difference between the UNE rates adopted in D. 00-06-080 and in D.01-02-042. No more accurate measure has been offered by any party. This differential represents the most objective measure of the magnitude of risk associated with the uncertainty over final UNE prices for Roseville. We shall therefore adopt this differential as the basis for the financial security to be provided by each qualifying CLEC.

We will apply the security requirement only to CLECs that have an interconnection agreement with Roseville and whose credit rating is below investment grade, as measured by a major credit rating agency such as Moody's Investor Service. We recognize that CLECs with at least an investment grade credit rating do not pose a significant enough credit risk to justify burdening them with an additional security requirement.

Any CLEC that meets the below-investment-grade criteria and that has purchased since January 2001, or is purchasing, UNEs from Roseville will be required either to post a bond letter of credit, guarantee, or to provide another comparable form of security, mutually acceptable to Roseville in an amount representing the difference between UNE payments at the rate adopted in D.00-06-080 and D.01-02-042. The CLEC shall have the option of selecting the specific form of security that it considers most suitable for its situation, and so notify Roseville.

The security requirements established in this order shall continue in effect until a subsequent Commission order issues adopting final UNE prices for Roseville pursuant to the rehearing granted by D.01-02-042. CLECs shall remit to Roseville at that time any outstanding sums relating to the difference between the final and interim UNE prices for all applicable prior periods. Upon a CLEC's remittance of the full amount due and payable pursuant to the final UNE prices, the security requirements established in this order shall terminate insofar as they are applicable to that CLEC. To the extent any CLEC fails to remit such UNE payments on a timely basis, Roseville shall be entitled to a priority claim on the funds secured pursuant to this order in order to satisfy outstanding debts owed for that CLEC's UNE underpayments.

Comments on Draft Decision

The draft decision of Administrative Law Judge Thomas R. Pulsifer in this matter was mailed to the parties in accordance with Section 311(g) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

Findings of Fact

1. Roseville entered into a number of interconnection agreements with CLECs which incorporated UNE rates equivalent to those adopted in D.00-06-080, regarding its arbitration with Covad.
2. In D.01-02-042, the Commission granted rehearing of D.00-06-080, and set lower interim UNE prices for Roseville based on Pacific Bell's UNE rates, with provision for a true-up once final UNE prices are determined for Roseville.
3. Roseville anticipates that its final UNE prices will be higher than its interim prices, and is concerned that at least some CLECs may have financial difficulty reimbursing Roseville for the balance due for past UNE purchases once the true-up amount is determined.
4. Anecdotal evidence of the financial problems facing at least some CLECs, established that such financially troubled CLECs could face cash flow difficulties in making up past UNE underpayments.
5. The issue of security deposits for underpayment of UNE prices was not previously raised as an issue by Roseville in its arbitration proceedings.
6. At the time Roseville negotiated or arbitrated interconnection agreements subject to UNE rates in effect prior to February 2001, it could not reasonably have foreseen that the Commission would grant rehearing of UNE rates in D.01-02-042, and create a new risk of underpayment of UNE charges.
7. Since rehearing was granted on the appropriate level of Roseville's UNE rates, there is uncertainty as to how close final UNE rates will be to the interim rates adopted in D.01-02-042.
8. Requiring CLECs to provide some form of financial security as proposed in Roseville's motion, will mitigate the risk that financially troubled CLECs will not

be able to make up potential underpayments of UNE charges once final CPUC rates are set.

Conclusions of Law

1. Roseville has provided a sufficient basis to justify imposing a generic financial security requirement on all CLECs with which Roseville has interconnection agreements that meet the criteria in Ordering Paragraph 3 below.

2. It is reasonable to presume that a CLEC that does not have an investment grade rating from a major credit rating agency has an increased financial risk of default on its UNE payments to Roseville.

3. Under Section 252(b)(4)(A) of the Act and Rule 3.10 of Resolution ALJ 181, the issues that may be decided by the Commission in interconnection agreement arbitrations are limited to those raised in the petition for arbitration and the response thereto.

4. Granting the relief requested in Roseville's motion does not violate rules against relitigating the arbitration of interconnection agreements, since the requested relief merely entails generic rulemaking in the Local Competition proceeding.

5. Independent of the arbitration process for any individual interconnection agreement, the Commission retains ongoing authority within this rulemaking proceeding to adopt or modify rules for local competition in the public interest.

6. Roseville should not be penalized for failing to negotiate a security provision in interconnection agreements related to a subsequent risk that was created by action of the Commission, because such risk was not reasonably foreseeable at the time Roseville negotiated or arbitrated interconnection agreements that predated D.01-02-042.

7. It is reasonable to adopt measures as set forth in the ordering paragraphs below to mitigate the risk of CLEC underpayment at issue here in view of the financial difficulties facing various CLECs, and in view of the uncertainties as to final UNE rates pursuant to the rehearing granted in D.01-02-042.

O R D E R

IT IS ORDERED that

1. The motion of Roseville Telephone Company for an order requiring security establishment of an acceptable form of a competitive local exchange carriers to mitigate the risk of potential underpayment of unbundled network element prices is granted to the extent set forth below.

2. Any CLEC that meets the criteria prescribed in this order and that has purchased or is purchasing UNEs from Roseville under rates set in D.01-02-042 shall be required to provide evidence to Roseville of financial security in a form as set forth below.

3. The security requirement adopted in this order shall only apply to CLECs that have an interconnection agreement with Roseville and whose credit rating is below investment grade, as measured by a major credit rating agency such as Moody's Investors Services.

4. To satisfy the requirements for financial security under this order, qualifying CLECs may elect either to post a bond letter of credit, guarantee, or to provide a comparable form of security that is mutually acceptable to Roseville. The security shall represent the difference between UNE payments at the rate adopted in D.00-06-080 and that adopted in D.01-02-042.

5. The security requirements established in this order shall continue in effect until a subsequent Commission order adopts final UNE prices for Roseville pursuant to the rehearing granted by D.01-02-042.

6. Following issuance of a Commission order establishing final UNE prices for Roseville, CLECs shall remit to Roseville any outstanding sums relating to the difference between the final and interim UNE prices for all applicable prior periods since the issuance of D.01-02-042.

7. Upon a CLEC's remittance of the full amount due and payable pursuant to the final UNE prices, the security requirements established in this order shall terminate insofar as they are applicable to that CLEC.

This order is effective today.

Dated _____, at San Francisco, California.